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Nos. 86-71 & 86-97

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

CTS CORPORATION,
Appellant,

—v.—

DYNAMICS CORPORATION OF AMERICA,
Appellee.

STATE OF INDIANA,
Intervenor-Appellant,

—v.—

DYNAMICS CORPORATION OF AMERICA,
Appellee.

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

AMICUS CURIAE BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF APPELLEE

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Pursuant to Rule 36.2 of this Court, and with the consent of the parties, The Securities Industry Association, Inc., submits this brief as *amicus curiae* in support of appellee Dynamics Corporation of America.

THE INTEREST OF THE SECURITIES INDUSTRY ASSOCIATION, INC.

The Securities Industry Association, Inc. ("SIA") is a trade association comprised of approximately 500 securities brokers and dealers transacting business both nationally and internationally. Its membership is responsible for over ninety percent of the securities brokerage business conducted in this country and includes members of every national securities exchange as well as securities firms that are not members of any exchanges.

SIA's members service securities investors of every size and type and perform a complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market making, underwriting and other investment banking activities, various exchange floor functions, and money management and investment advisory services. As a consequence, SIA is generally recognized as a spokesman for the securities industry in general and the broker-dealer community in particular.

The issues in this case involve the constitutionality of the so-called "second generation" of state takeover statutes, which are designed to regulate, and in most instances discourage, tender offers for corporate control other than those favored by incumbent management. These statutes purport to replace an earlier series of state tender offer statutes whose unconstitutionality was determined by this Court in *Edgar v. MITE*, 457 U.S. 624 (1982) ("*MITE*"). In fact, however, the efforts undertaken by the states since *MITE* to accommodate their takeover legislation to the concerns articulated by this Court in that case have been largely cosmetic. The primary purpose and effect of the state takeover statutes, to delay and deter unsolicited control acquisitions, has remained unaltered in the transition from the pre-*MITE* statutes to the more modern variety, of which the statute under review is a typical example.

As a recognized spokesman and representative of the securities industry on legislative and policy matters, SIA has re-

garded with growing concern the spectre of renewed efforts at local regulation of the national securities market by means of state takeover statutes. There are few economic phenomena less local and more national in character than tender offers for corporate control. Tender offers are offered on a non-discriminatory nationwide basis to all shareholders of a target corporation. Where large public corporations are involved, these shareholders will generally be found in nearly every state in the Union. Indeed, because the shares of such corporations are generally traded on a daily basis on one or another of the nationwide securities exchanges it is generally impossible to pinpoint, on a geographic basis, where all shareholders are located.

Shareholders who choose to accept an offer will generally send their acceptances and, eventually, their stock certificates, to the bidder's depository, whose offices will usually be located in one of the nation's major financial centers, outside the state of residence of most target shareholders and, more often than not, outside the state of domicile of either the bidder or the target corporation. Other shareholders, rather than awaiting completion of an offer which might be withdrawn or defeated, often choose to seek an immediate cash premium by selling their shares on the open market at a price that will have risen significantly in the wake of the tender offer announcement. Such trading, which guarantees many shareholders a profit even when an offer is withdrawn, usually takes place on the floor of a national exchange, which again is usually located in a state unrelated to the domicile of shareholder, target or bidder.

In the above ways and others, tender offers impact directly and substantially on the national securities market. The market factors and processes underlying these tender offers are consequently nationwide in character and—save for the impact of the local state statutes under review—are affected only slightly, if at all, by considerations specific to any single locality.

State attempts to regulate, and, in most cases, burden, nationwide tender offers occasion several negative results for

shareholders. In the first place, by discouraging and deterring tender offers, they deny to shareholders the premium values characteristic of such offers. Additionally, the threat, theoretical or actual, of a tender offer often forces an inefficient or insensitive management to respond more directly to shareholders' concerns with a consequential improvement in the market position of the corporation's stock. The removal of such threat is likely to have a depressing effect on the shares of such corporations and ultimately on the securities market as a whole. *MITE*, 457 U.S. at 643.

Furthermore, even where local statutes do not ultimately thwart a tender offer, they inevitably add a high level of confusion and uncertainty to the tender offer process. Under the federal scheme, set up by the Williams Act, the rules and processes for tender offers are clear, uniform, and straightforward. Brokers, dealers, investment advisors and the other members of the securities industry are generally conversant with their details. The superimposition upon this interstate framework of a variety of state regulatory schemes differing in their particulars cannot help but confuse shareholders and their investment advisors in reaching the economic decisions they must make with respect to their shares.

It is the position of SIA that tender offers, for all the controversy focused on them in recent years, are on the whole a beneficial influence on the national economy and on the national securities market. Even if additional regulation were thought to be necessary to deal with any abuses in the tender offer process, such regulation would be ultimately dysfunctional and detrimental to securities holders unless it were national in scope and operation. Through promulgation of the Williams Act, and through frequent consideration of additional legislation, Congress has shown itself equal to the task of providing the necessary regulation.

Conversely, local legislation, impacting upon and burdening nationwide tender offers, clearly interferes with the interstate commerce in corporate securities. Such legislation disturbs the existent federal regulatory framework established by Congress

with respect to tender offers and complicates any additional steps Congress may take with respect to regulating this interstate phenomenon. These considerations underlay this Court's decision in *MITE*, which effectively eliminated the first generation of state takeover legislation. It is respectfully submitted that these same considerations mandate a similar conclusion with respect to the statute under review, as well as with respect to all local statutes similarly devised to evade the effects of the *MITE* ruling.

SUMMARY OF ARGUMENT

During the 1960s, tender offers arose as an increasingly common method for the achievement of corporate control. Pursuant to this method of control acquisition, potential acquirors, by-passing the sometimes hostile managements of target corporations, placed their offers to purchase controlling interests in corporations directly before the target's shareholders. Although tender offers generally offered substantial premiums to shareholders, and, additionally, conferred economic benefits to the economy as a whole, *MITE*, 457 U.S. at 633, Congressional concern increased over the fact that, at the time, tender offers operated in a regulatory vacuum, outside the disclosure requirements of the federal securities laws, and with no specified time period in which they were required to remain open.

The legislative reaction was the Williams Act, whose underlying purpose was to regulate tender offers for the protection and benefit of shareholders faced with a request to tender their shares. While, in its formative stages, the proposed Williams Act legislation was infused with an avowedly pro-management viewpoint, Congress' increasing realization of the substantial economic benefits conferred by tender offers led it to adopt, instead, a regulatory scheme designed not to inhibit tender offers, but rather characterized by a strict neutrality between the interests of incumbent target management, on the one

hand, and those of the offeror on the other. *See MITE*, 457 U.S. at 633.[1] The Williams Act legislation, as ultimately adopted, provided that shareholders receive full and timely disclosure with respect to matters material to their investment decisions and that tender offers proceed within a time frame carefully calibrated to benefit neither bidder nor management.

In the years since the promulgation of the Williams Act, tender offers have become an increasingly significant phenomenon in our nation's economic life. While Congress has often been requested by groups responsive to existing corporate management to enact legislation more restrictive of hostile takeovers, it has consistently declined to upset the delicate neutral balance embodied in the Williams Act.

These efforts, however, have often found more sympathetic ears in the state legislatures, which bodies are, in any case, more easily subject to the influences and pressures of local corporations. Thus, although at the time of the promulgation of the Williams Act there existed virtually no state legislation purporting to regulate acquisitions of corporate control,[2] in the years following a large number of states adopted statutes specifically designed to regulate tender offers. In most instances these state takeover statutes imposed requirements more burdensome on offerors than those provided for in the federal statute. These sometimes took the form of additional disclosure obligations and requirements for prior administrative review and approval of tender offers. Almost universally, such statutes established time frames which virtually assured that tender offers could not be consummated during the time

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1 The legislative history amply reveals that the promulgators of the Williams Act had no intention to inhibit tender offers and even believed that the act "might encourage them." Nor did Congress intend to deny to shareholders "the opportunities which result from the competitive bidding for a block of stock of a given company," 113 Cong. Rec. 24,665-6 (1967) (remarks of Sens. Williams and Javits).

2 In 1968, when the Williams Act was enacted, Virginia was the only state which had a takeover statute and its law had been recently passed and never enforced.

periods established under the Williams Act. While the constitutionality of such statutes was consistently challenged, these takeover statutes often provided target managements with effective tools to at least delay a hostile offer until a more secure defensive device could be implemented.

Finally, this Court, in *MITE*, addressed head-on the question of the constitutionality of the state takeover statutes. A clear majority of the Court held that the Illinois takeover statute violated the Commerce Clause of the Constitution by the impermissible restrictions it imposed upon interstate securities transactions. A plurality of the Court, additionally, held that the statute violated the Supremacy Clause of the Constitution by obstructing the regulatory scheme established by Congress in the Williams Act. With respect to each of these constitutional bases the operative impermissible characteristic of the statute was the same—that it operated to delay and impede nationwide tender offers for corporate control.

Following this Court's ruling in *MITE*, the state takeover statutes then extant were consistently struck down by the courts, or their enforcement abandoned by state regulatory commissions. Very recently, however, the investment community has witnessed the resurrection of the state takeover statutes in a different garb. Under the prodding of local corporate managements, states have increasingly adopted "second generation" takeover statutes variously labelled as "control share" statutes or "business combination" statutes. These statutes purport to regulate not the tender offer process itself, but rather the purchase of shares pursuant to such offers or the exercise of the essential rights of such shares following the purchase of corporate control.[3] While the statutes may vary in their particulars, their purpose and effect is identical—to delay,

3 "Control share" statutes generally provide that one seeking to purchase more than a specified percentage (often 20%) of a corporation's stock cannot complete such purchase absent the approval of a majority of the shareholders of the corporation. The potential acquiror is generally excluded from participating in such vote. The Indiana statute under review technically permits a sale transaction to occur

impede and ultimately thwart nationwide tender offers and corporate control acquisitions.

Any differences between these "second generation" statutes and the pre-*MITE* legislation they replaced are more apparent than real. As the Court of Appeals in the instant case noted, while such statutes are "[c]leverly drafted . . . to skirt judicial holdings that forbid states to delay tender offers beyond the period required by the Williams Act, *the cleverness is fairly transparent*." 794 F.2d at 261 (emphasis supplied). Where the purpose of a local statute is to delay and discourage hostile tender offers and where the direct effect of the statute is the same, the particular form and method utilized to achieve this result should not immunize the statute from constitutional attack. To hold otherwise would be to permit form to rule

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prior to shareholder approval but blocks the transfer of any voting rights absent such approval.

"Business combination" statutes operate to block an acquiror's ability to undertake a wide series of corporate transactions for an extended period of time even if he has purchased most or all of the shares in a target corporation. Thus, Indiana's business combination statute, Ind. Code, § 23-1-43-1 *et seq.* (1986), which is not the subject of the instant appeal, limits the acquiror's ability to cause the corporation to engage in a wide number of corporate transactions, including mergers, liquidations and the sale, lease, exchange, mortgage, pledge, transfer or other disposition of assets or the issuance of dividends beyond stated percentages and stated amounts. These restrictions, however, apply only in the case of a hostile acquiror.

The purpose and effect of both types of statutes is to deter and discourage anyone from purchasing a control interest in a corporation. Thus, for example, while the State of New York in its *amicus* brief (at p. 9) seeks to characterize its own business combination statute as more neutral than the Indiana statute under review, the Governor's Program Memorandum, 1985 N.Y. Laws Chap. 915, accompanying the New York statute, candidly acknowledged that "the effect of the legislation" was "to encourage a potential acquiror to negotiate its proposed acquisition with the board of directors *and to discourage unilateral takeovers* that depend on the assets of the target." *Id.* at p. 8 (emphasis added).

We suggest that the Court, if it invalidates the Indiana control share statute, make it clear in its opinion that other statutes such as business combination statutes which similarly attempt to evade the *MITE* holding and impede takeovers will also not pass constitutional muster.

substance, and to open the door to facile evasions of the Court's constitutional ruling.[4]

It is respectfully submitted that *MITE* and its progeny are fully dispositive with respect to the Indiana statute and to the generality of "second generation" takeover statutes of which it is representative. The continued attempt to use these statutes to undermine federal policies and overstep constitutional boundaries can only be prevented by this Court's declaration, in unambiguous terms, of the plain unconstitutionality of any state legislation which obstructs the nationwide securities market by setting up delays and impediments to nationwide tender offers and other control acquisitions.

ARGUMENT

I. THE INDIANA STATUTE IS PREEMPTED BY THE WILLIAMS ACT

A. Under *Mite*, State Statutes Must Not Delay Or Impede Tender Offers

Under the preemption doctrine, which is founded upon the Supremacy Clause of the Constitution, a state law will be deemed unconstitutional where such law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *Jones v. Rath Packing Co.*, 430 U.S. 519, 526, 540-41 (1977). In *MITE*, a plurality of this Court held that a state statute whose terms operated to impede and delay nationwide tender offers was unconstitutional in that it constituted an

4 Not surprisingly, the courts which have considered the "second generation" state control acquisition statutes have, following *MITE*, ruled such statutes unconstitutional under either the Commerce or Supremacy Clauses of the Constitution or both. *See, e.g.*, in addition to the decision under review, *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135 (6th Cir. 1986); *Gelco Corp. v. Coniston Partners*, C.A. No. 3-86-847 (D. Minn. Nov. 10, 1986); *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985); *APL Ltd. Partnership v. Van Dusen Air, Inc.* 622 F. Supp. 1216 (D. Minn. 1985); *Terry v. Yamashita*, 643 F. Supp. 161 (D. Hawaii 1986).

obstacle to the purposes and objectives of Congress in enacting the Williams Act which regulates the making and, in particular, the timing of such tender offers.

It is respectfully submitted that the plurality opinion in *MITE* was correct and that the same grounds and reasons which led the plurality to apply the preemption doctrine in *MITE* clearly mandate a finding of unconstitutionality with respect to the Indiana statute at issue here.

The plurality opinion in *MITE* held that the Illinois statute at issue in that case conflicted impermissibly with the Williams Act in that, in its pro-management leanings, it disturbed the balance of strict neutrality between management and offeror which Congress, in enacting the Williams Act, had determined to provide the best protection for shareholders in corporate control contests.

> There is no question that in imposing these requirements, Congress intended to protect investors. But it is also crystal clear that a major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder. . . . As Senator Williams explained:
>
> > "We have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids."
>
> 113 Cong. Rec. 24,664 (1967). This policy of "evenhandedness" represented a conviction that neither side in the contest should be extended additional advantages vis-a-vis the investor, who, if furnished with adequate information, would be in a position to make his own informed choice. We, therefore, agree with the Court of Appeals that *Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice.*

457 U.S. at 633-34 (emphasis supplied) (citations omitted).[5]

A particular element of this carefully balanced approach adopted by Congress with respect to tender offers involved granting to the target's shareholders sufficient time to receive and digest the informational materials required to be distributed under the Williams Act while, at the same time, not permitting tender offers to be so delayed as to impede their consummation or grant to target management an undue advantage in resisting takeover attempts.

> . . . Congress intended to strike a balance between the investor, management and the takeover bidder. The bidder was to furnish the investor and the target company with adequate information but there was no "inten[tion] to do . . . more than give incumbent management an opportunity to express and explain its position." Once that opportunity was extended, Congress anticipated that the investor, if he so chose, and the takeover bidder should be free to move forward *within the time frame provided by Congress.*

Id. at 634 (emphasis added) (citations omitted).

Noting that "[d]elay has been characterized as the most potent weapon in a tender offer fight" (*id.* at 637 n.12), the plurality of this Court concluded, on the basis of the legislative history of the Williams Act as well as subsequent Congressional expressions of policy, that timing was an integral element of the legislative scheme inherent in the Williams Act. Indeed the plurality in *MITE* concluded, correctly we submit, that the Illinois statute violated the Supremacy Clause precisely

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5 The clear intendment of Congress to adhere to a policy of strict neutrality in corporate control contests was recently reaffirmed by the unanimous opinion of this Court:

> The expressed legislative intent [of the Williams Act] was to preserve a neutral setting in which the contenders could fully present their arguments.

Schreiber v. Burlington Northern, Inc., 105 S. Ct. 2458, 2463 (1985).

by reason of the fact that the provisions of such statute contained the potential for delays greater than that provided in the time framework mandated under the Williams Act. *Id.* at 639.[6]

B. The Second Generation Statutes Violate The Williams Act's Policy Of Neutrality

In the instant case the shareholder vote provisions of the Indiana statute similarly offend against the time-frame mandated by the Williams Act by virtually assuring that any tender offer conducted pursuant to the Indiana statute will be subject to delays greater than those established by the Williams Act. The statute further provides that the ability to engender such delays shall lie exclusively in the hands of target management. In this manner the careful neutral balance which this Court has recognized to be the essential policy of the Williams Act is overthrown.

Appellants' attempts to reconcile the Indiana statute with the Williams Act are unavailing. Thus, they argue that the potential fifty-day delay imposed on bidders under the statute is no greater a burden upon tender offers than the delays imposed when bidders must leave their offers open due to the necessity of obtaining prior state or federal regulatory approvals, such as those required, for example, under the Hart-Scott-Rodino Antitrust Improvements Act. Appellants' analogy could not be more inapposite. There is no meaningful similarity between delays necessarily imposed by external and neutral regulatory requirements and delays operating at the option and for the benefit of a hostile target management. The extent of any delays created by the need to secure anti-trust approvals will not depend on whether a proposed acquisition is friendly or not. Conversely, the maximum delays permissible under the Indiana statute will occur only when target manage-

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6 Securities and Exchange Commission ("S.E.C.") regulations promulgated pursuant to the Williams Act provide that the bidder is not required to keep his tender offer open for more than twenty business days. See 17 C.F.R. § 240.14e-1(a) (1986).

ment wants them to and will serve no separate regulatory function.

Appellants further argue that, unlike the statute deemed unconstitutional in *MITE*, the Indiana statute does not delay commencement or even consummation of the tender offer. Under the statute, they claim, a bidder is free to close his offer within the Williams Act time frame and only his subsequent voting rights are affected. To the objection that no rational tender offeror will purchase shares when he doesn't know if he will ever be able to vote them, appellants offer a "practical alternative" (Brief of Intervenor-Appellant State of Indiana ("Indiana Brief") at pp. 62-73). They claim a purchaser can close an offer within the Williams Act's time frame but make his purchases of target's stock conditional on subsequent shareholder approval of his voting rights.

However, appellants' "practical alternative"—in itself, complex, burdensome, and unprecedented—ignores the basic negative qualities of delay in tender offer situations which have caused it to be termed "the most potent weapon" against hostile takeovers. Delay permits target management time to set up a wide array of defensive measures—ranging from corporate restructuring, to poison pills, to self-tenders, to defensive acquisitions—designed to irrevocably block and impede the takeover even if the shares already have been tendered. *See MITE*, 457 U.S. at 638 n.13. Such defensive actions can be as easily undertaken during the fifty-day delay prior to a shareholder vote under the Indiana statute as during a delay prior to the commencement or closing of a tender offer. The "practical alternative" offered by appellants therefore does nothing to cure the negative effects of the delays which this Court condemned in *MITE* but which the Indiana statute still permits target management to effect.

Furthermore, by excessively extending the period between the announcement of an intention to make a bid and the actual successful completion of the offer, the Indiana statute pro-

motes the very uncertainty and market volatility which the Williams Act was intended to minimize.[7]

C. The Second Generation Statutes Violate The Williams Act's Policy Of Investor Autonomy

The Indiana statute, moreover, conflicts with the Williams Act in an even more fundamental way. Thus, the Indiana statute clearly establishes as a practical matter that no tender offer can be consummated by any rational bidder absent a shareholder vote that will grant him the voting rights that are the reason for the offer in the first instance. This, in effect, requires the bidder to conduct and win a proxy contest with target management before he can purchase shares from any shareholders. Yet the Williams Act clearly intended that the decision to tender one's shares be one that rested with the *individual* shareholder alone and that it was *not* to be made subject, by statute, to another's control or veto.

Thus, one of the vices of the Illinois statute, as found by the plurality opinion in *MITE*, was that it made the individual shareholder's ability to accept a tender offer subject to the judgment of others—in that case, the Illinois Secretary of State:

> The Court of Appeals *understood the Williams Act and its legislative history to indicate that Congress intended for investors to be free to make their own decisions. We agree.* Both the House and Senate Reports observed that the Act was "designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision." H.R. Rep. No. 1711, 90th Cong., 2d Sess., 4

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7 Rule 14d-2, 17 C.F.R. § 240.14d-2 (1985), promulgated pursuant to the Williams Act, which requires a tender offer to commence not more than five days after public announcement of a bid, was adopted on the basis that longer delays would encourage excessive market and arbitrage activity and thereby "deny security holders the protections which that Act was intended by Congress to provide," Exchange Act Release No. 16384, 44 Fed. Reg. 70,326 (1979), at 70,329. In adopting Rule 14d-2, the S.E.C. stated an express intention to pre-empt state takeover statutes then existent which, by permitting longer delays, operated to "frustrate the operation and purposes of the Williams Act." *Id.* at 70,330.

> (1968); Senate Report, at 3. Thus, as the Court of Appeals said, "[t]*he state thus offers investor protection at the expense of investor autonomy—an approach quite in conflict with that adopted by Congress.*"

Id. at 639-40 (emphasis supplied).

The individual shareholder's autonomy with respect to his investment decision is no less restricted by being made subject to the veto of other shareholders. This indeed has been the holding of the courts which, since *MITE*, have considered control share statutes similar to the Indiana statute. *E.g.*, *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 756 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986) (Ohio Control Shares Acquisition Act unconstitutional on preemption grounds because "it prevents the individual investor from deciding whether to sell his or her stock . . . and places the decision in the hands of other shareholders of the target company."); *Icahn v. Blunt*, 612 F. Supp. 1400, 1420 (W.D. Mo. 1985) (Missouri statute unconstitutional where decision of "whether to buy or to sell [control shares] would be taken out of the hands of the shareholder and the purchaser and placed in the hands of management and other shareholders").

Appellants argue that whatever its purpose or impact, the Indiana statute is constitutionally acceptable because it purports technically to deal with the internal governance of corporate affairs, an area that is the exclusive domain of the states, rather than with the sale or acquisition of securities in a tender offer. Such an elevation of form over substance would, however, be an absurd constitutional principle: if it were accepted, a state could simply provide that a hostile offeror could never merge with the target company, never receive dividends, never have representation on its Board of Directors, or never be allowed to choose corporate officers, all matters which similarly can be said to be matters of "internal governance." The purpose and impact of a statute, and not its title or placement in the state statute book, obviously should determine its constitutional merits.

Indeed, even if viewed mechanistically, the Indiana statute still would not pass constitutional muster, since it is directed not to corporate activity, but rather to the purchase and sale of shares among shareholders. Unlike staggered boards, cumulative voting, or supermajority provisions (corporate governance devices cited by appellants as within the state's power to legislate), which protect minority rights within a corporation by regulating the circumstances pursuant to which the *corporation* can undertake certain actions, the control share statutes operate to directly regulate and discourage transactions among individual shareholders.

Furthermore, unlike the control share statutes, the traditional corporate governance provisions cited by appellants do not operate primarily or exclusively against an acquiror seeking corporate control.[8] The Indiana statute however operates *solely* and *punitively* against a bidder for corporate control. Rather than incidentally affecting his ability to influence the operations of the corporation, it immediately and instantly—upon purchase of the control shares—eliminates the voting rights of his stock and his ability to exercise influence, let alone control, over the company. It is clear, in short, that "internal corporate affairs" is a mere facade for regulation designed directly to deter and delay hostile tender offers.

The State of Indiana does not, in fact, seriously dispute that this is the statute's purpose and effect. Thus, it concedes (Indiana Brief at pp. 91-95) that one effect of the Indiana legislation will be to substantially deter partial tender offers although such tender offers have been consistently recognized

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8 Indeed, the effects of these common corporate governance provisions apply even where corporate ownership is diffused. A supermajority provision may operate just as well to prevent a merger favored by a majority of individual shareholders of a corporation as to prevent a merger favored by a single controlling shareholder. Indeed, such provisions can even benefit a potential acquiror. Thus, a potential acquiror holding 20% of a corporation's voting stock can benefit from an 80% supermajority merger requirement by being able to block a defensive merger undertaken by management. Similarly, cumulative voting guarantees him representation on the board even prior to his achieving a majority position. It is only the takeover statutes, such as the one at issue, which cut but one way—in favor of incumbent management.

as permissible under the Williams Act. And it admits further that the intent and "practical effect" of the statute is to replace the federal securities law policies of the Williams Act with the securities policies of the United Kingdom:

> [T]he Indiana Statute will have a practical effect analogous to that of legislation in the United Kingdom which requires majority shareholder approval of tender offers. The British regulations allow shareholders to simultaneously tender their shares and vote for or against the offer.

Indiana Brief at 95.

While economists might profitably argue the merits of the British approach versus the informed free-market policy embodied in federal law, it is respectfully submitted that the issue of the right of any state to make this choice was settled long ago in our federal Constitution. It is difficult to imagine a clearer violation of the Supremacy Clause than for a state, in a matter broadly affecting the national economy, to choose to adopt the legislative approach of a foreign power over that of the Congress of the United States.

In short, the clear legislative intent of the Williams Act and the reasoning underlying the plurality opinion in *MITE* mandate a finding that the Indiana statute upsets the balance struck by the Williams Act, and is, hence, unconstitutional.

II. THE INDIANA STATUTE VIOLATES THE COMMERCE CLAUSE OF THE CONSTITUTION

In *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 106 S. Ct. 2080 (1986), this Court, relying *inter alia* on its plurality opinion in *MITE*, recently reaffirmed the "two-tiered approach" traditionally followed in determining the constitutionality of state economic regulation under the Commerce Clause:

> When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor

> in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.

106 S. Ct. at 2084 (citations omitted). Under either of the two tests applied "the critical consideration is the overall effect of the statute on both local and interstate activity." *Id.*

In *MITE*, a majority of this Court determined that a state statute that regulated and restricted the purchase and sale of securities pursuant to a nationwide tender offer violated the Commerce Clause in that the substantial burdens it imposed upon interstate commerce outweighed the putative local benefits intended to be served by the legislation. This Court, by a plurality of four justices, additionally held that, irrespective of the balance of national and local interests, the state takeover statute violated the Commerce Clause, because such legislation constituted a direct, rather than incidental, regulation of interstate tender offers, a vehicle of interstate commerce.

As has been noted, the second generation post-*MITE* state takeover statutes, of which the Indiana statute is a fair example, differ only in form from the statute struck down in *MITE*; their intended and operative effects remain the same. The identical reasoning and constitutional considerations which impelled the overturning of the Illinois statute in *MITE* consequently mandate a similar determination with respect to the Indiana statute under review.

A. The Indiana Statute Is Unconstitutional Per Se As A Direct Burden on Interstate Commerce

> [A] state statute which by its necessary operation directly interferes with or burdens [interstate] commerce is a prohibited regulation and invalid, regardless of the purpose with which it was enacted.

MITE, 457 U.S. at 642 (plurality opinion), citing and quoting this Court's decision in *Shafer v. Farmers Grain Co.*, 268 U.S. 189, 199 (1925).

The Indiana statute constitutes a direct burden upon interstate commerce in that the practical effect of the statute is to burden, regulate, and restrict interstate securities transactions outside the territorial jurisdiction of the state. That nationwide tender offers constitute interstate commerce was clearly determined by this Court's decision in *MITE* and cannot be disputed by appellants. 457 U.S. at 641-42 (plurality opinion).

Indeed, in the sheer multitude of its myriad securities transactions carried out across state lines and national boundaries, few business phenomena exhibit more of the characteristics of interstate and international commerce and less of the indicia of localized transactions than does the modern tender offer. The commerce in control shares generally does not involve discussions or negotiations in any particular locality. Buyers and sellers rarely if ever meet. The operative transfers of securities involved occur anonymously and often simultaneously on the floor of a national exchange or by mail or wire receipt of a transmittal form at the central offices of a designated depository.[9] The transactions of this nature involved in even a single moderate-sized tender offer may account for hundreds of millions of dollars in interstate commerce, and tender offers generate transactions involving many billions of dollars of interstate commerce yearly in the United States.

The drastic impact of control share statutes such as Indiana's on such interstate securities transactions simply cannot be questioned. The Indiana statute plainly restricts and burdens the ability of a bidder to purchase and the shareholder to sell, by means of a tender offer or other control share acquisition, securities of a target company. The Indiana legislation so

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9 In nationwide tender offers, generally, the consummation of all sale and purchase transactions with respect to the shares tendered pursuant to the offer occur at a single moment, upon the expiration of the offer. At that moment, under the customary terms of the offer, the shares are deemed "accepted" for payment. Actual payment, usually by mail or wire transmittal, occurs shortly afterwards.

operates even though neither the bidder nor the majority of target's shareholders may reside in Indiana and although no operative act of the tender offer will occur in that state.

The Indiana statute accomplishes its burdensome and intrusive effect by granting to entities other than the bidder or the individual investor the ability to delay and thwart, as a practical matter, the tender offer or proposed stock transaction. Thus, as discussed above, under the statute, target management is given the power to delay consummation of the tender offer sufficiently beyond the periods mandated by federal law so as to facilitate defensive mechanisms that may permanently defeat the bid. The shareholder approval provisions further deter tender offers by denuding shares purchased pursuant to such offers of any voting rights, making the regaining of such rights subject to a subsequent vote by a majority of the other shareholders. At best, such provisions force the bidder to follow up his offer with an expensive and time-consuming proxy contest.[10] At worst, it may leave him, having already paid premium value, with "control" shares which give him no influence, let alone control, over the corporation.

The plain effect of these provisions, in most cases, will be that tender offers for target corporations subject to such statutes will simply not be made unless favored and approved in advance by incumbent management. In the rare event that an unsolicited tender offer is conducted, it will be made subject to the condition of subsequent shareholder approval, a condition that management, using the time provided by the statute's built-in delay, will seek to assure will never be met. The attendant difficulties and uncertainties created for the bidder will, in any case, virtually guarantee that, even where tender offers do proceed under the Indiana statute, a much lesser cash premium will be extended to shareholders in the offering price.

Although the Indiana statute's restrictive effect on nationwide tender offers is especially apparent, the statute's

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10 Indeed, under the Indiana statute not only must the bidder bear his own expenses in such a contest but he must also give "an undertaking to pay the *corporation's* expenses" in calling and holding the required stockholders meeting. Ind. Code § 23-1-42-7(a) (1986) (emphasis supplied).

burdensome effect on interstate commerce is not restricted to its effect on tender offers alone. The Indiana statute would substantially deter any unsolicited acquiror from purchasing—on the open market, by privately negotiated transaction, or otherwise—any shares that would bring his total shareholdings in the corporation to over 20%. Yet the vast majority of transactions thus affected would clearly not involve Indiana residents or acts taking place in Indiana. The Williams Act, by contrast, only requires that full disclosure as to intentions and background of a holder of over 5% of an issuer's shares be made prior to any additional purchases. The substantial burdens added on by the Indiana statute clearly restrict, in a major fashion, the freedom of non-resident shareholders to engage in interstate commerce.

As the plurality in this Court determined in *MITE*, the imposition by a state of such extraterritorial burdens on a nationwide tender offer directly regulates and restricts interstate commerce and constitutes a *per se* violation of the Commerce Clause.

> [T]he Illinois law, unless complied with, sought to prevent MITE from making its offer and concluding interstate transactions not only with Chicago Rivet's stockholders living in Illinois, but also with those living in other States and having no connection with Illinois. . . . It is therefore apparent that the Illinois statute is a direct restraint on interstate commerce and that it has a sweeping extraterritorial effect.

MITE, 457 U.S. at 642.

The conclusions reached in MITE, it is submitted, apply equally to the 'second generation' statutes enacted to avoid MITE's clear impact. Such, at least, has been the consensus of the courts which since *MITE* have considered control share acquisition laws such as the Indiana statute. *See Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. at 760-61; *Icahn v. Blunt*, 612 F. Supp. at 1415-16; *Dynamics Corporation of America v. CTS Corp.*, 794 F.2d at 264; *Terry v. Yamashita*, 643 F. Supp. at 165.

Appellants' contention that the Indiana statute does not regulate interstate commerce because it achieves its deterrent effect through elimination of voting rights rather than through a technical prohibition on the purchase or sale of the target's securities argues on behalf of a formalism which has long since been rejected by this Court. As this Court has made clear, it is not form but *practical effect* that will be determinative on the issue of whether a state's economic regulation impermissibly intrudes on interstate commerce. *E.g., Southern Pacific Co. v. Arizona*, 325 U.S. 761, 775 (1945) (state law overturned on Commerce Clause grounds where "practical effect of such regulation is to control [conduct] . . . beyond the boundaries of the state . . . ."); *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 106 S. Ct. 2080 at 2086 (fact that New York law "is addressed only to sales of liquor in New York is irrelevant if the 'practical effect' of the law is to control liquor prices in other States."); *MITE*, 457 U.S. at 643 (plurality opinion).

In short, the Seventh Circuit's observation on the effect and operation of the Indiana statute is fully accurate:

> [I]n this case the effect on the interstate market in securities and corporate control is direct, intended, and substantial; it is not merely the incidental effect of a general regulation of internal corporate governance. The law in question is an explicit regulation of tender offers; that the mode of regulation involves jiggering with voting rights cannot take it outside the scope of judicial review under the commerce clause. Any other conclusion would invite facile evasions of the clause.

794 F.2d at 264. The Indiana statute, as a direct state attempt to regulate interstate commerce, is thus unconstitutional *per se*.[11]

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11 Appellants' recurrent emphasis that the Indiana statute must be constitutional because it is 'non-discriminatory' is merely a red herring. The Indiana statute is offensive to the Commerce Clause not because it discriminates against other states but because it operates to burden and regulate interstate commerce, which alone is sufficient to violate the Commerce Clause. Lack of discrimination only becomes an

B. No Significant Local Benefits Exist Which Outweigh The Indiana Statute's Substantial Interference With Interstate Commerce

In *MITE* this Court determined that no local benefits purportedly conferred by "first generation" takeover statutes, such as the Illinois law overturned in that case, were commensurate with the statutes' "substantial" adverse effects on interstate commerce. These adverse effects were, in the Court's view, drastic in impact and national in scope, affecting both target shareholders and the national economy as a whole:

> The effects of allowing the [state regulatory authority] to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

457 U.S. at 643.

Such negative impact on non-resident shareholders, non-resident bidders and the United States economy were, this Court observed, offset by no substantial countervailing local benefits conferred on the state or its residents: "Insofar as the Illinois law burdens out-of-state transactions, *there is nothing to be weighed in the balance to sustain the law.*" *Id.* at 644 (emphasis supplied).

The burdensome impact on interstate commerce created by control share statutes such as Indiana's is identical to, if not greater than, those arising out of the "first generation" pre-*MITE* statutes. Indeed, appellants do not seriously contend that the national market in control shares will continue undis-

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issue where, as in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the statute is designed to affect transactions occurring solely within a state's own borders and thus, absent a discriminatory effect, would pose no constitutional problem.

turbed in the face of these "second generation" statutes. Nor, indeed, do they set against this substantial interference with interstate commerce any substantive local benefits allegedly accruing from the Indiana legislation. Appellants rather respond with a talismanic formula—the "internal affairs" doctrine—the mere invocation of which they suppose sufficient to dissipate all constitutional concerns like so much mist.[12]

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12 Indiana, while not seriously claiming that its legislation will leave tender offers unaffected, puts forward the unique suggestion that the Indiana statute will facilitate rather than impede corporate takeover acquisitions. Making the Indiana statute sound like nothing so much as a Hostile Bidders' Bill of Rights, the State stresses that the law allows offerors an "immediate shareholder vote on the merits of their offers," and that the moral suasion flowing from a favorable vote in this plebiscite will make it more difficult for management to "wage war" against a hostile bid. (Indiana Brief at pp. 75-76). Indeed, Indiana suggests that, by mandating a shareholder vote on voting rights, within "only" 50 days, the "months-long" duration of "bitterly fought takeover battles" will be truncated (Indiana Brief at p. 102).

This prognosis is not only disingenuous in concept, but also flies in the face of logic and experience. Under the federal regulatory scheme tender offers are not required to remain open longer than twenty business days, approximately half the time span provided for by Indiana's provision for an "immediate" shareholder vote. If some tender offers now extend beyond the Williams Act's twenty day period it is primarily because (a) other bidders have arisen and a prolonged auctioning process has ensued; (b) legal deficiencies, such as securities or anti-trust violations, have been found to exist in the bidder's offer; or, most commonly, (c) target management has put in place defensive strategies, in the form of poison pills, self-tenders, or the like, and consummation of the tender offer is made to await judicial determinations as to the propriety of these entrenchment measures designed "to wage war" against the offer. Statutes such as Indiana's obviously do nothing to eliminate the first two of these causes of delay and would *contribute* to the final cause by giving target management more time to implement defensive tactics, generating even further delay.

In sum, the argument that the statute is intended to confer benefits on hostile acquirors is as much of a facade as the statute itself. Far better the candor of the Indiana Chamber of Commerce, which participated in the formulation and drafting of the statute, and which concedes in its *amicus* brief (at p. 18 n.9) that one of the purposes of the statute was "protecting the quality of corporate governance in Indiana *by granting certain protections to corporate directors*" (emphasis supplied).

Thus, appellants contend that because the Indiana statute on its face deals with voting rights of shareholders, which appellants claim, under the "internal affairs" doctrine, to be the province of the states, the practical effect of the statute to deter and burden extraterritorial interstate securities transactions may be conveniently ignored. Appellants' argument proves too little, too much, and, ultimately, nothing at all.

As this Court observed in *MITE*, when faced with the identical argument, the internal affairs doctrine is not a concept relevant to constitutional law but a principle of the conflict of laws. Such principle apportions the power to regulate corporations *between* the States so as to avoid inconsistent rulings or legislation:

> The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands. *See Restatement (Second) of Conflicts of Laws* § 302, Comment b, pp. 307-308 (1971). That doctrine is of little use to the State in this context. Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.

457 U.S. at 645.

There is no basis for attaching to this doctrine constitutional implications. That courts will apply Delaware law to Delaware corporations and Indiana law to Indiana corporations does not mean that either Delaware or Indiana is permitted to enact, under an "internal affairs" rubric, corporate laws that, in violation of the national Constitution, impermissibly intrude upon interstate commerce. The danger of inconsistent rulings which the internal affairs doctrine was intended to minimize is simply not implicated where an area is determined by the Commerce Clause to be the province of federal jurisdiction to the exclusion of that of *any* of the states.

Thus, even were the instant statute predicated on a good faith concern with respect to the internal affairs of Indiana corporations, this would, nevertheless, still not provide the Indiana legislature with *carte blanche* to ignore constitutional limitations and intrude upon interstate commerce.[13] In the instant case, however, appellants' attempts to justify the Indiana statute under the pretext of the internal affairs doctrine are in any event a mere charade. Even the enacters and enforcers of second generation statutes such as Indiana's do not pretend that their statutes are not designed to regulate and restrict hostile tender offers. As noted above, Indiana itself admits that the practical effect of its legislation is to substantially deter otherwise legitimate partial tender offers and to implement a British approach to tender offers by requiring majority approval of shareholders for the sale of control shares.

Similarly, the State of Minnesota, which has enacted a second generation control share statute of its own, admits in its *amicus* brief to this Court ("Minn. Brief") that the purpose and effect of such statutes is to "inhibit the abusive use of takeover tactics" and to mitigate the supposedly "coercive nature of control share acquisitions" (Minn. Brief at 11). The State of New York, as noted, has similarly admitted, for its own part, that the effect of its legislation is to "discourage unilateral takeovers" (*supra* at p. 8 n. 3). It is thus clear that the states themselves do not deny the fully-intended impact of their control share statutes on tender offers.

That the State of Indiana effects such regulation of tender offers through *in terrorem* provisions respecting essential voting rights rather than by directly prohibiting purchases of the tendered shares themselves makes, as has been noted, no

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13 *See*, for example, ***Brown-Forman Distillers***, where, despite the "wide latitude" given the States under the Twenty-First Amendment "to regulate the importation and distribution of liquor within their territories," this Court overturned provisions of a New York law regulating the sale of liquor on the basis of the statute's "practical effect" on interstate commerce. 106 S. Ct. at 2086.

practical or legal difference. It is as if a state rather than prohibiting the rental of automobiles permitted their rental—but with their engines removed. As the State of Minnesota has stated in the *amicus* brief it has filed *on behalf of* Indiana's position (*id.* at 15), to attempt any distinction of the Indiana statute on this basis "elevates form over substance":

> Although the [Indiana statute] does not actually require shareholder approval prior to the control share acquisition, the practical effect of the Indiana statute may be just that.

Id. at 15 n.15.

If the practical effect of a state statute is to regulate and restrict tender offers, the nature of the particular device effecting such regulation, or the chapter heading of the corporate statute pursuant to which it takes place, cannot be of any constitutional significance. To accept otherwise is to open the door to wholesale regulation of interstate commerce by any state willing to cloak its economic regulation under an appropriate facade. A state, under such a theory, would presumably have the constitutional authority to permanently strip control shareholders of voting rights upon a vote, not of the majority of shareholders, but simply of the incumbent board of directors. For that matter the rights could be removed without recourse to any vote at all, if the state determined that this were an appropriate policy. Nor would a state's regulation be limited to removal of voting rights; it could choose to strip the bidder of dividend rights or of any of the other indicia of ownership as well.

Appellants' invocation of such traditional state corporate governance rules as supermajorities and cumulative voting, as examples of permissible internal governance statutes which impact on interstate commerce, does nothing to support their contentions. As has been noted, such true corporate governance statutes, which genuinely seek to regulate the internal operations of the corporation, bear no relation to the Indiana statute's direct attempt to influence the purchase and sale of

securities between *shareholders* of the corporation and other shareholders or third parties. Indeed, these statutes demonstrate the power of the states to adequately legislate internal corporate governance to protect minority shareholders without recourse to legislation designed to obstruct the interstate securities market or national tender offers.[14]

Similarly, it adds nothing to appellants' arguments to point out that the voting rights stripped away by the Indiana statute in control share transactions are themselves creatures of state corporate law. Such an argument proves too much, since the same could be said with respect to any of the rights attached to corporate securities. Indeed, such securities themselves, as an ultimate matter, are nothing more or less than an agglomeration of various contract and property rights, all created and sustained under state law. This meta-legal truth, however, has never caused this Court or Congress any hesitation in considering transactions involving the sale or purchase of these bundles of rights as interstate commerce. Indeed, the extensive federal regulation of the securities markets, including the Williams Act, is based squarely on the assumption that such transactions do constitute interstate commerce.

In sum, the balancing test required under the Commerce Clause for the Indiana statute is no different than that which was undertaken by this Court in *MITE*. As in *MITE*, the statute here is clearly unconstitutional.

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14 The attempt to support the Indiana statute as an exercise in "shareholder democracy" (*see, e.g.*, Minn. Brief at p. 11) is particularly disingenuous, especially in view of the act's direct effect and intent to disenfranchise shareholders who would otherwise possess over 20% of the shareholder vote, a singularly undemocratic provision.

CONCLUSION

This Court should affirm the judgment below.

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